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DE RUEHBM #0647/01 2271335

ZNR UUUUU ZZH

P 141335Z AUG 08

FM AMEMBASSY BUCHAREST

TO RUEHC/SECSTATE WASHDC PRIORITY 8589

INFO RUEHSL/EUROPEAN POLITICAL COLLECTIVE PRIORITY

UNCLAS SECTION 01 OF 03 BUCHAREST 000647

STATE FOR EUR/CE - ASCHEIBE

ALSO FOR EUR/OHI - AMBASSADOR KENNEDY

SIPDIS

SENSITIVE

E.O. 12958: N/A

TAGS: [EFIN](#) [ETRD](#) [ECON](#) [CASC](#) [PGOV](#) [RO](#)

SUBJECT: ROMANIA : PROPERTY FUND IS HIRING PROFESSIONAL MANAGERS AND GOING PUBLIC

Sensitive but Unclassified, not for Internet distribution.

¶1. (SBU) Summary: The long process of establishing a property restitution fund to reimburse former owners of certain expropriated properties is finally drawing to a close. The four billion Euro fund has already distributed nearly 20 percent of its outstanding shares and is in the final stages of completing a listing on the Bucharest Stock Exchange. The last major hurdle to clear before the fund is ready to list, hiring a professional asset manager, is underway. According to the Property Fund's Executive Vice President, Daniela Lulache, the letters of intent received by the Fund's board from top asset management companies are impressive. While at the same time, the President of the National Authority for Property Restitution (ANRP), Ingrid Zaarour, has made procedural changes which should allow many of the stickiest outstanding restitution cases to be brought to a close. End Summary.

BACKGROUND

¶2. (SBU) The GOR established the fund in 2005 to compensate victims of illegal communist expropriation for cases where the actual return of property is no longer possible, e.g. in cases where a school was built on the site of a former home. The fund provides financial compensation by granting shares, to both victims and their heirs, in a fund comprising state-owned companies and privatized companies in which the GOR has retained a minority stake. The fund currently contains shares in 88 Romanian firms, with large stakes in companies such as: Petrom, Transelectrica, Transgaz, Romgaz, the Romanian Post Office, Hidroelectrica, EON Gaz Romania, and the Otopeni airport. Former property owners apply for compensation from the ANRP, which assesses the current market value of the expropriated properties and issues damage titles for fund shares. The initial face value of one share was established at 1 RON (approximately US 40 cents). The owners of the Property Fund shares will be able to sell them freely on the regulated capital market.

¶3. (SBU) The fund is managed by a supervisory board appointed by the Ministry of Economy and Finance. The current management, including the executive Vice President, appear highly professional. They have operated in a manner that protects the fund's assets, while generating a return for shareholders. They do not have the scope or authority to dispose of the fund's underlying assets, but are able to conduct capital market operations to generate additional dividends. The fund was also designed to be transparent, and outside companies have been hired to provide accounting and advisory services. According to George Mucibabici, the Chairman of Deloitte Romania, Deloitte's recent audit confirmed that the books are being kept in a manner consistent with generally accepted accounting principles.

NEW MANAGEMENT AND AN EXCHANGE LISTING

¶4. (SBU) The recently released list of asset management companies seeking to take over the fund is impressive, and includes several

major U.S. and international companies. Letters of intent were received from the following U.S. companies: JP Morgan, Blackrock, Artio Global Management, New Century Holdings, Morgan Stanley Investment Management, and Goldman Sachs Asset Management. Other multinational bidders include: HSBC Bank (U.K.), UBS Global Asset Management (Switzerland), Deutsche Bank (Germany), Royal Bank of Scotland (U.K.), Barclays Capital (U.K.), BNP Paribas Asset Management (Austrian subsidiary), and Credit Suisse (Germany), as well as other smaller outfits. The current management, with the advice of a GOR-appointed commission, will begin direct negotiations to select the bidder offering the best mix of experience and competitive pricing to the fund's shareholders. According to Commissioner Nicolae Cinteză, Director of Bank Supervision at the Romanian Central Bank, the commission will complete its work and hopes to have the management firm take over the fund no later than January 1, 2009. The new management firm will have input into the future investment strategy of the fund and will work in conjunction with the current managers to develop a fund prospectus. According to Lulache, her long-term idea is for the fund to become a South Eastern Europe investment fund, investing not only in Romania, but also in other neighboring countries. However, in the near term the fund's current assets will leave it primarily focused on the Romanian energy market. The listing on the stock exchange will take place once the new management team is in place and the fund prospectus has been published.

¶5. (SBU) While Lulache said that she was committed to listing the fund on the stock exchange, in her opinion, the listing needs to be pursued at a deliberate, measured pace, taking into account local capital market conditions. The opposing view, held by Cinteză, is that the longer listing is postponed, the more opportunities it creates for unscrupulous businessmen to grab shares at below-market prices on the unregulated market. While the ultimate goal is to have

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the price per share exceed the face value, according to Cinteză, it is likely that shares will initially trade in the range of .5-.7 RON. After the initial price fall, the price per share should rise as the new management company begins to make strategic investments and the market price adjusts to reflect the expected future earnings, rather than the current asset value. One concern about the listing is that at the current estimated value of 4 billion euros, the fund will likely double the capitalization of the Bucharest Stock Exchange (BVB). Lulache suggested that the fund would consider a listing on an additional foreign stock exchange, most likely in London, to dilute this impact. Having a dual-listed fund will have the added benefit of making investment more accessible to foreign portfolio investors, and should result in higher share prices. Regardless, the initial public offering remains on schedule for the first half of 2009, with any additional listings occurring at a later date.

¶6. (SBU) About 80% of the fund is currently under state ownership, while 20% is in private hands. The state owned portion is falling as property restitution cases are brought to a close and claimants are allocated shares in the fund by the GOR. At present, shares are allocated at face value (1 RON). After the listing, shares will be distributed at the market price, albeit using a formula to protect against market manipulation. By using a weighted average of the last 60 trades together with the average trading price on the first 60 days after listing, it will be difficult for traders to influence the number of shares distributed to any particular claimant through a few large well-timed trades. These provisions will help to protect the fund and the shareholders if the market turns out to be less liquid than expected.

THE ANRP'S VIEW

¶7. (SBU) ANRP President Zaarour met with ACS Chief and EconOff on the Property Fund and restitution issues. She expressed her frustration with the slow pace of property restitution, blaming the lack of clear legislation in the years immediately following independence. She explained that, after years of communism and then additional lost time in the initial post-communist period, in-kind restitution has become more difficult to provide. Streets, factories, and schools have replaced some of the former properties,

while the establishment of a property fund lagged due to the political opposition of the PSD. Zaarour now believes that sufficient legislative backing exists to bring Romania's property restitution saga to a close. She offered to examine any of the lingering AmCit property restitution cases to see if they could now be settled under the ANRP's authority. She pointed out that the legislation governing property restitution has shifted responsibility from the localities to her agency, giving her increased authority to settle on a final compensation offer. While there is a ceiling of RON 500,000 on cash reimbursements, there is no ceiling on the number of property fund shares that may be allocated to claimants. Reimbursements for amounts larger than RON 500,000 will be paid using either property fund shares or a combination of cash and shares, up to the property's current market value.

¶8. (SBU) Zaarour also explained in more detail the procedure for determining the value of expropriated properties. The assessment is conducted by independent assessors, paid by ANRP, who are required to work in accordance with international professional standards. For non-agricultural property, the independent assessors must be members of the national professional association (ANEVAR). The assessment attempts to establish a current market price for the property, using criteria such as location, size, and comparable sales. Those former owners who have historical records, such as maps, photos, and old fiscal records will likely be more satisfied by this process than those possessing more limited information about the property, according to Zaarour. There is one internal appeal allowed after the evaluation, either by ANRP or the former owners, after which an independent arbitration process will set a final market value in cases of disagreement. The window to file new restitution cases closed permanently for all types of property in 2005 and Zaarour expressed her hope that all pending cases could now be expeditiously resolved.

COMMENT

¶9. (SBU) Begin Comment: The property fund is firmly established in law and the progress leading up to a stock exchange listing is well advanced. The fact that so many marquee foreign companies are jockeying to manage the fund's assets reflects a belief that, once listed, they will be able to add significant value through the careful stewardship of the fund's assets. Those who have acquired shares at the current face value of one RON per share are likely to see these shares multiply in value in the medium to long term. While listing on the stock exchange will in some ways signal the end of this process, the current shareholders are not holding worthless

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paper. The shares are already generating substantial yearly dividends, and while they cannot yet be sold on the regulated market, they are providing income to the shareholders.

¶10. (SBU) One significant benefit deriving from a stock exchange listing is that the non-regulated market for shares will disappear. Until a transparent market price has been established, there remains a concern that the claimants, who have already suffered the loss of their property, will sell-out for quick cash to the same cast of characters who enriched themselves on the mass privatization certificates twelve years ago, and miss out on a substantial monetary return on the property they lost. Another concern is the caution of American citizens who, having fought years of interminable battles in local courts and who rightly or wrongly perceive corruption in every shadow, are unwilling to accept shares in a property fund. Rather they continue to demand cash or property-in-kind. Convincing these individuals, despite our generally positive view of the property fund, may prove difficult. Furthermore, with national elections expected in November, the helpful and professional disposition of ANRP could change with a new government. End comment.

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